SOUTH PACIFIC ISLANDS

Table 1	**2021**
Population, million	
Samoa	0.20
Tonga	0.10
Vanuatu	0.31
GDP, US$, billion	
Samoa	0.79
Tonga	0.50
Vanuatu	1.00
GDP per capita, current US$	
Samoa	3954
Tonga	4993
Vanuatu	3253

Sources: WDI, World Bank staff estimates.

The economies of Samoa, Tonga and Vanuatu have been hit by natural disasters and the COVID-19 pandemic. These South Pacific countries just recorded their first COVID outbreaks. Tonga's outbreak was amid a volcanic eruption and subsequent tsunami. Strict travel restrictions have hit tourism-related activity with negative spillovers on the rest of the economy. Governments need to continue supporting the vulnerable and embark on structural reforms to support inclusive economic recovery.

Key conditions and challenges

Natural disasters and external shocks pose a constant threat to livelihoods, economic growth, and fiscal sustainability in the South Pacific. Enhancing resilience to external shocks is crucial to supporting long-run growth and achieving sustainable improvements in living standards and poverty reduction. Economic activity may remain depressed for another six to nine months as authorities remain cautious about border reopening to prevent overburdening their weak public health systems. The delayed recovery creates significant potential for scarring effects in the longer term, particularly in the tourism sector. Lost firms and jobs create adverse structural changes to the economy that are not reversed when aggregate demand recovers. These changes would disproportionately affect the lower educated, whose skills may not be as transferable to other sectors. The economic shocks and slow recovery also greatly increase the risk of poverty, particularly as households deplete savings and assets to cope with lost incomes.

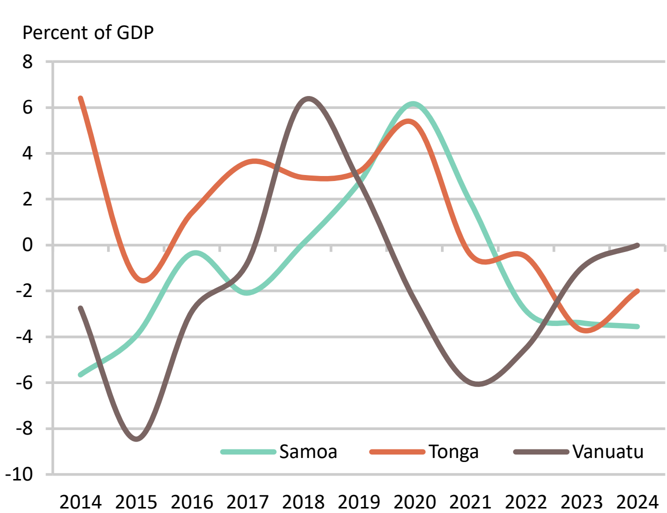
The main immediate challenge for all three countries is to contain the domestic COVID-19 outbreak. In addition, Vanuatu needs to sustain its recent uptick in vaccinations to minimize health and economic impacts from the outbreak while Tonga needs to prioritize response and recovery from the recent tsunami. The near-term challenge will be to strike an appropriate balance between catalyzing a sustainable and inclusive economic recovery and maintaining macroeconomic balance in the face of several competing pressures. With limited fiscal space and low capacity to carry debt, governments need to prioritize strategic measures that lay the foundation for the economic recovery, while also supporting livelihoods for the bottom 40 percent of households. Effective implementation of structural reforms will be critical to ensure a sustainable economic recovery.

Recent developments

Border closures helped temporarily contain the pandemic but created economic downturns. Substantial donor funding cushioned the negative impact on fiscal and external balances. While the COVID-19 vaccination roll-out has been progressing well in Samoa and Tonga with approximately 90 percent of the adult population fully vaccinated as at end-February 2022, it has been relatively slow in Vanuatu. It lags with only 48 percent of the adult population fully vaccinated.

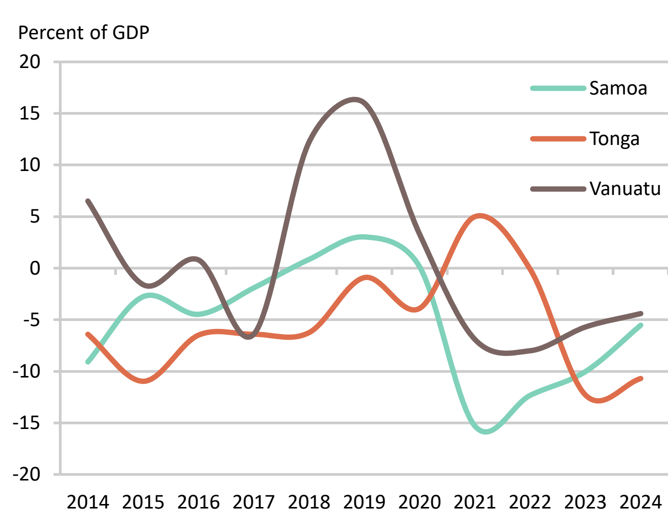
The **Samoan** economy recorded a historical-high recession in FY21. While border closure prevented domestic transmission of COVID-19, it resulted in a sharp contraction of tourism and related industries, and hindered construction activity. Despite policy support and robust remittances, real GDP declined by 8.1 percent. Poverty is likely to have risen from the pre-pandemic level, with urban areas affected more due to the higher concentration of

FIGURE 1 South Pacific Islands / Overall fiscal balance



Sources: National sources and World Bank projections.

FIGURE 2 South Pacific Islands / Current account balance



Sources: National sources and World Bank projections.

jobs in the service sector. Substantial development partner grants, spending under-execution and favorable tax revenue outturn, reflecting improved tax compliance and the phased rollout of the Tax Invoice Monitoring System (TIMS) helped attain a fiscal surplus of 1.9 percent of GDP. The current account recorded a substantial deficit (15.3 percent of GDP) as tourism receipts came to a standstill.

The **Tongan** economy is estimated to have contracted by 0.8 percent in FY21, due to the impacts of COVID-19 and TC Harold—a category 5 cyclone that struck the country in April 2020. These shocks have resulted in a slowdown in the tourism, retail, and agriculture sectors. However, a severe contraction was avoided due to the fiscal stimulus implementation, ramp-up of reconstruction activities from TC Gita (2018) and TC Harold, and buoyant remittance inflows. A marginal fiscal deficit of 0.4 percent of GDP was recorded, supported by relatively high grants and better-than-expected domestic revenue collections. Robust remittances and lower service imports helped attain a current account surplus (5 percent of GDP).

In **Vanuatu**, following a deep economic recession in 2020, growth is estimated to have recovered to 1.2 percent in 2021. The economic recovery was underpinned by continued fiscal stimulus, which supported livelihoods and funded reconstruction activity related to TC Harold. A sizeable fiscal deficit of 6 percent of GDP was recorded in 2021, driven by a fall in sovereign rents, particularly lower Economic Citizenship Program (ECP) receipts, alongside increased expenditures. The current account recorded a deficit of 8 percent of GDP, predominantly driven by subdued tourism receipts.

Outlook

The near-term outlook remains dependent on the duration of COVID-19 related travel restrictions and the economic fallout from the Russia-Ukraine war. Among others, achieving herd immunity through vaccination is a key trigger for border reopening. Most of the adult population are expected to be fully vaccinated by end-March 2022 in Samoa and Tonga. In Vanuatu, vaccination demand has increased substantially due to the community transmission of the COVID-19. Tourism activity is expected to be sluggish in the near-term and gain momentum over the medium-term. While premature border reopening could have implications on the domestic COVID situation, economic activity will be constrained for as long as international travel restrictions remain in place. The implication is that poverty rates across the three countries will gradually decline as economic activity picks up and jobs become available but will remain higher than pre-pandemic levels until full economic recovery is achieved.

In **Samoa**, an economic contraction of 0.3 percent is projected in FY22, reflecting the global growth slowdown and COVID-related impact but is projected to accelerate to 3.8 percent by FY24. The recovery is expected to be driven by a gradual resumption of tourist activity from FY23, spillovers to other sectors and ramping up of capital projects. The fiscal balance is projected to record a deficit of 2.9 percent of GDP as development partner grants normalizes and capital expenditure picks up pace. With the delayed recovery in tourism, the current account deficit is projected to persist in FY22. The twin deficits are expected to narrow over the medium-term consistent with the economic recovery.

In **Tonga**, the economy is expected to contract by 1.6 percent in FY22, reflecting the impact of the recent tsunami on agricultural production, the commercial sector and tourism, aggravating the COVID-related impact. Borders are expected to remain closed until end of FY22 as the country battles its first COVID-19 outbreak. Growth is expected to rebound to 3.2 percent in FY23 and FY24 driven by reconstruction activity, recovery in agriculture production, and gradual pick-up in tourism receipts. The fiscal and current account deficits are projected to remain elevated in FY23-24 as reconstruction activities and recovery efforts take place, before narrowing over the medium term.

In **Vanuatu**, GDP growth is expected to accelerate to 3-4 percent between 2022-2024, supported by a gradual pick up in tourism and cyclone reconstruction activity. In tandem, the poverty rate is projected to gradually decline from 36.6 percent in 2022 to 35.9 percent in 2024. In the near term, the community transmission of COVID-19 is negatively affecting growth. The fiscal deficit is projected to deepen in 2022 – due to lower ECP revenues and increased COVID-spending but narrow onwards. A balanced budget is expected by 2024 as the recently passed Tax Administration Act helps boost tax revenues and the COVID stimulus is gradually withdrawn. These are expected to outweigh the projected decline in ECP revenues. Similarly, the current account deficit is projected to gradually narrow to approximately 4.4 percent of GDP by 2024, driven by a recovery in travel receipts.

TABLE 2 South Pacific Islands / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices						
Samoa	4.4	-2.6	-8.1	-0.3	2.5	3.8
Tonga	0.7	0.7	-0.8	-1.6	3.2	3.2
Vanuatu	3.9	-6.8	1.2	2.0	4.1	3.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]						
Vanuatu	32.3	37.6	36.9	36.6	36.1	35.9

Sources: World Bank and IMF.
e = estimate; f = forecast.
Note: Financial years for Samoa and Tonga are July-June, for Vanuatu it is January-December.
(a) Calculations based on EAPPOV harmonization, using 2019-NSDP.
(b) Projection using neutral distribution (2019) with pass-through = 1 (High) based on GDP per capita in constant LCU.